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CITATIONS

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In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 1311

OSCAR NELSON, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the court below (R. 25–32) is reported in 69 F. Supp. 336.

JURISDICTION

The judgment of the court below was entered January 6, 1947. (R. 32.) On February 12, 1947, the petitioner filed a motion for a new trial which was overruled on March 3, 1947. (R. 32.) The petition for a writ of certiorari was filed May 2, 1947. The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925, as amended by the Act of May 22, 1939.

QUESTION PRESENTED

The question is whether the basis of shares of "A" corporation which petitioner received as a stockholder of "B" and "C" corporations without the surrender of shares of "B" and "C" is the allocated cost of the shares of "B" and "C". The answer depends upon whether the "A" shares were distributed pursuant to a tax-free reorganization within the meaning of Section 203 (h) (1) (A) of the Revenue Act of 1926 and Section 112 (i) (1) (A) of the Revenue Act of 1928.

STATUTES INVOLVED

The applicable portions of the pertinent statutes are set forth in the Appendix, *infra*, pp. 14–17.

STATEMENT

The special findings of fact of the Court of Claims (R. 11–25) may be summarized as follows:

In his return for the year 1929, petitioner reported a capital net gain from the sale of United Carbon Company preferred stock which had been acquired during the year 1925. From petitioner's records the Commissioner of Internal Revenue determined that part of the stock thus sold had been acquired by petitioner through distributions by the Cosmos Carbon Company and the Natural Gas Products Company, hereinafter referred to as Cosmos and Natural Gas, in proportion to his stockholdings in these two companies, and that the

distributions were made pursuant to a plan of reorganization without surrender of their stock in the distributing corporations and therefore the proper basis for computing capital gain was an allocated part of the original cost of petitioner's investment in the stock of Cosmos and Natural Gas. (R. 12–14.)

On January 19, 1938, petitioner filed a claim for refund for the year 1929, alleging therein that, of the preferred stock of the United Carbon Company sold by him during the year 1929, part was received as distributions by the Natural Gas and Cosmos; that the distributions were not made pursuant to the plan of reorganization; and that the basis of the computation of gain or loss upon the disposition thereof was the fair market value of the stock at the time it was received by him as distributions from Natural Gas and Cosmos. This claim for refund was disallowed in full by the Commissioner of Internal Revenue. (R. 14.)

Petitioner was president and general manager of Cosmos and Natural Gas. During the year 1923, the petitioner conceived the idea of uniting into one organization a number of other companies engaged in the production of oil and gas and the manufacture of carbon black and gasoline for the purpose of eliminating competition and the formation of a single sales agency for all. After discussing the matter of pooling the assets of various companies engaged in the manufacture

of carbon black with the general manager of the Liberty Carbon Company and the Louisiana Carbon Company, the officers of other companies and partnerships were approached concerning the proposition. A meeting of representatives of numerous companies and partnerships was held during the year 1924, and as a result thereof, appraisals of the properties of various companies and partnerships interested in the proposition were made. After the completion of the appraisals, it was decided that a new corporation would be formed to be known as the United Carbon Company. A committee for the incorporators of the United Carbon Company was formed, and such committee submitted to each of the various interested companies and partnerships similar written proposals. (R. 14–15.)

In the proposals the offer was made to acquire for cash all carbon black inventories and all supplies inventories used in the packing and shipping of carbon black. The proposals further provided that the United Carbon Company would acquire all of the property, real, personal and mixed, of the various corporations and partnerships, except cash, notes and accounts receivable, and inventories of carbon black and supplies in exchange for preferred stock of the United Carbon Company and voting trust certificates representing non-assessable shares of common stock of the United Carbon Company. It was further pro-

vided in the proposals that the transferors would continue to be liable for all their debts, and would protect and save harmless the United Carbon Company from all claims of every kind and character against such transferors. It was also the understanding of the transferors, including Cosmos and Natural Gas, that they would all join in a voting trust agreement covering the voting of the United Carbon Company's common stock for a period of five years. (R. 15–17.)

The United Carbon Company was incorporated on February 19, 1925, for the purpose of carrying on the kind of business theretofore conducted by the transferors. The primary purpose of the new corporation was the unification of properties of each predecessor into a single ownership for a more efficient operation thereof. The proposals were accepted by twelve corporations, including Cosmos and Natural Gas, and a partnership and the properties designated in the proposals were transferred to United Carbon Company as of February 14, 1925, in exchange for cash and preferred stock and voting trust certificates for common stock. (R. 17–18.)

Cosmos transferred approximately 91.6%, and Natural Gas 95.7% of their assets to the United Carbon Company in exchange for cash and preferred stock and voting trust certificates for common stocks. The assets retained were used to liquidate liabilities. Cosmos distributed to its

stockholders cash and preferred and voting trust certificates for common stock, and thereafter dissolved on August 2, 1927. Natural Gas distributed to its stockholders cash, preferred stock and voting trust certificates for common stock, and thereafter dissolved on June 24, 1926. (R. 18–23.)

ARGUMENT

The only question in this case is the basis for measuring gain or loss on the petitioner's sale in 1929 of certain shares of preferred stock of the United Carbon Company which had been distributed to the petitioner as a stockholder of Cosmos and Natural Gas in 1925, 1926 and 1928. The Commissioner determined, and the Court of Claims held, that these shares were distributed to the petitioner pursuant to a reorganization (to which all of these corporatons were parties), the United Carbon shares being distributed by Cosmos and Natural Gas without the surrender of their own shares so that the distribution was tax-free under Section 203 (c) of the Revenue Act of 1926 (Appendix, *infra*) (identical with Section 112 (g) of the Revenue Act of 1928), and accordingly the basis of the Cosmos and Natural Gas shares should be allocated as between those shares and the United Carbon shares in accordance with the provisions of Section 113 (a) (9) of the Revenue Act of 1928. (Appendix, *infra.*) The petitioner makes no contention that these sections

would not be applicable if there was a reorganization. His contention is that there was no reorganization.

1. The decision of the court below holding that there was a reorganization within the meaning of Section 203 (h) (1) (A) of the Revenue Act of 1926 (Appendix, *infra*) (which is identical with Section 112 (i) (1) (A) of the Revenue Act of 1928) is clearly correct. There was a plan of reorganization whereby it was contemplated that Cosmos and Natural Gas and ten other corporations would transfer substantially all of their assets to a new corporation (United Carbon) in exchange for stock and cash.[1] Pursuant to this plan there was a transfer of substantially all of the assets of Natural Gas and Cosmos to the United Carbon Company in exchange for preferred stock and voting trust certificates for common stock.[2] This satisfied the continuity of interest requirement of a Clause A reorganization.

[1] One partnership was also included, but this case does not involve any question as to whether the assets of the partnership were acquired in a reorganization. (R. 18.)

[2] The bulk of the assets were acquired for stock (R. 19, 22), the common stock being placed in a voting trust as these corporations and other participating corporations agreed (R. 15–17). Cash was paid for inventories and supplies on hand. (R. 19, 22.) United Carbon did not assume the liabilities of Cosmos and Natural Gas, they retained certain assets, chiefly cash, accounts receivable and notes, and were not immediately dissolved. (R. 19, 20, 22.)

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Helvering v. *Minnesota Tea Co.*, 296 U. S. 378; *Nelson Co.* v. *Helvering*, 296 U. S. 374.

The petitioner's suggestion (Pet. 10–11) that there was no reorganization since no one of the transferor corporate persons or its stockholders held a controlling interest in the stock of the United Carbon Company immediately after the exchange, is without merit, for Clause A reorganizations as distinguished from Clause B reorganizations make no requirement as to control. *Nelson Co.* v. *Helvering, supra*, p. 377, and *Helvering* v. *Minnesota Tea Co., supra*, p. 384. Nor is it material that there was not a statutory merger or consolidation for Section 203 (h) (1) (A) of the Revenue Act of 1926 and Section 112 (i) (1) (A) of the Revenue Act of 1928 do not refer to statutory mergers and consolidations. See *Helvering* v. *Limestone Co.*, 315 U. S. 179. It is equally immaterial that the corporations were not immediately dissolved. *G. & K. Mfg. Co.* v. *Helvering*, 296 U. S. 389.

2. The principal contention of the petitioner is that where a number of corporations transfer their assets to a new company, the same proportional interests in the assets must be retained by those corporations or their stockholders, and that the decision in *United Carbon Co.* v. *Commissioner*, 90 F. 2d 43 (C. C. A. 4th), conclusively established that the same proportionate interests were not retained in this case.

It is obvious that Section 203 (h) (1) (A) of the Revenue Act of 1926 and Section 112 (i) (1) (A) of the Revenue Act of 1928 contain no requirement as to retention of proportionate interests in the transferred property where several corporations are involved in a reorganization. In fact this Court has held that the circumstance that the relation of the transferor to the assets conveyed is substantially changed is not material since this is not prohibited by the statute. *Helvering* v. *Minnesota Tea Co., supra; G. & K. Mfg. Co.* v. *Helvering, supra.*

The decision in *United Carbon Co.* v. *Commissioner, supra,* on which petitioner relies, does not support his position and is in no way controlling here. The sole question there considered by the Circuit Court of Appeals for the Fourth Circuit was whether Section 203 (b) (4) of the Revenue Act of 1926 (Appendix, *infra*), which does not deal with reorganizations but with transfers of property to controlled corporations, was applicable so that the United Carbon Company was required to use the transferor's basis in determining depreciation with respect to the transferred property. The court held that since proportionate interests were not retained in the transferred assets Section 203 (b) (4) had no application and hence the United Carbon Company was not precluded from using a stepped-up basis for determining depreciation by Section 204 (a) (8). It did not consider whether there was

a reorganization or basis provisions applicable in the case of reorganizations.

That the Circuit Court of Appeals for the Fourth Circuit did not consider whether or not there was a reorganization or whether or not the retention of proportionate proprietary interest was necessary for the purpose of a reorganization is made very clear by the later decision of the court in *Britt* v. *Commssioner,* 114 F. 2d 10. That case involved the question of basis of preferred stock of United Carbon Company which the taxpayer there involved had received in exchange for stock of the Liberty Carbon Company, one of the transferors of assets in the reorganization. In that case the Circuit Court of Appeals for the Fourth Circuit held that there was a reorganization and a nontaxable exchange of stock for stock so that the new stock took the basis of the old. In answer to the taxpayer's contention that the *United Carbon* decision controlled, the court stated that Section 203 (b) (3) of the Revenue Act of 1926 (Appendix, *infra*) correctly described the transaction and that section would have been applied in the *United Carbon* case had the Commissioner based his contention on that section instead of upon a subsection that did not fit the facts.[3]

[3] The Court of Claims also considered that the transactions here were tax-free to the corporation under Section 203 (b) (3) and (e) since the cash received was ultimately distributed to the stockholders.

Not only did the *United Carbon* case not involve any question as to a reorganization but the issue was the basis of the transferred property in the hands of the corporation and not, as here, the basis of the United Carbon stock in the hands of stockholders. The petitioner does not go so far as to contend that the decision in that case is *res judicata* here and such a contention was correctly rejected in the *Britt* case. Apart from the fact that different issues were involved in the *United Carbon* case, it is clear that a corporation and its stockholders are separate and distinct legal entities. *Dalton* v. *Bowers,* 287 U. S. 404; *United States* v. *Phellis,* 257 U. S. 156; *Eisner* v. *Macomber,* 252 U. S. 189; *Peterson* v. *Chicago, Rock Island & Pac. Ry.,* 205 U. S. 364; *Hornstein* v. *Kramer Bros. Freight Lines,* 133 F. 2d 143, 146 (C. C. A. 3d). In this action the petitioner is suing in his individual capacity as a stockholder and he cannot be bound by action taken by the United Carbon Company in an action on its own account.

3. The decision of the court below is not in conflict with the opinion of this Court in *Helvering* v. *Cement Investors,* 316 U. S. 527, as claimed by petitioner. There the bondholders, by reason of proceedings under Section 77B of the Bankruptcy Act, became the equitable owners of the properties of the debtor corporations. Subsequently the properties were transferred to a

new corporation by the trustee or title holder on behalf, and with the authority, of the creditors, and such creditors received stock and bonds of the new corporation in exchange. In the opinion of the Court, the transfer of the properties by the creditors to the new corporation qualified as a nontaxable exchange under Section 112 (b) (5) of the Revenue Act of 1936, which is similar to Section 203 (b) (4) of the Revenue Act of 1926. This was not an inter-corporate transaction pursuant to a plan of reorganization within the meaning of Section 112 (g) of the Revenue Act of 1936 (which does not contain Clause A as it appears in the Revenue Acts of 1926 and 1928), because the ownership of the properties had passed from the debtor corporation to the creditors, and the latter then became the transferors. In the *Cement Investors* case, the transaction did not qualify as a reorganization under the reorganization section or as a nontaxable exchange pursuant to a reorganization under Section 112 (b) (4) of the Revenue Act of 1936 but qualified as a nontaxable exchange under Section 112 (b) (5), whereas here the transaction does qualify under Section 203 (h) (1) (A) of the Revenue Act of 1926.

4. The petitioner asks this Court to review a number of questions concerning Section 203 (b) (4) which are in no way involved in this case and, on the issues which are involved, suggests no reason why further review is required.

CONCLUSION

The petition for certiorari presents no question warranting review, and should therefore be denied.

Respectfully submitted.

GEORGE T. WASHINGTON,
Acting Solicitor General.
SEWALL KEY,
Acting Assistant Attorney General.
HELEN R. CARLOSS,
H. S. FESSENDEN,
Special Assistants to the Attorney General.

JUNE 1947.

APPENDIX

STATUTES INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 201. * * *

* * * * *

(c) Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 202, but shall be recognized only to the extent provided in section 203. * * *

* * * * *

SEC. 203. (a) Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 202, shall be recognized, except as hereinafter provided in this section.

(b) * * *

* * * * *

(3) No gain or loss shall be recognized if a corporation a party to reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(4) No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange

for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * *

(c) If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

* * * * *

(h) As used in this section and sections 201 and 204—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term a "party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

* * * * *

SEC. 286. This title shall take effect as of January 1, 1925, except that section 257 and sections 271 to 285, inclusive, and this section, shall take effect on the enactment of this Act.

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(9) *Tax-free distributions.*—If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in section 112 (g), the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed;

* * * * *

Section 112 (b) (4) and (5) of the Revenue Act of 1928 are identical with Section 203 (b) (3)

and (4), respectively, of the Revenue Act of 1926; Section 112 (g) is identical with Section 203 (c) of the Revenue Act of 1926, and Section 112 (i) is identical with Section 203 (h) of the Revenue Act of 1926.

U. S. GOVERNMENT PRINTING OFFICE: 1947